

## Internal Revenue Service

Department of the Treasury  
Washington, DC 20224

Number: **201006015**

Release Date: 2/12/2010

Index Number: 851.02-00

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B02

PLR-128058-09

Date:

November 4, 2009

### Legend:

Fund =

State A =

a =

Dear :

This responds to your letter dated June 3, 2009, and supplemental correspondence dated October 15, 2009, submitted by your authorized representative on behalf of Fund. Fund requests that the Internal Revenue Service rule that discharge of indebtedness (DOI) income arising from the repurchase of certain debt instruments constitutes qualifying income under section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the Code).

### Facts:

Fund is a State A corporation registered as a business development company (BDC) under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the 1940 Act). As a BDC, Fund is engaged in the business of providing financing to middle market companies through long-term debt and equity capital investments. Fund has elected to be, and intends to qualify each year as a regulated investment company (RIC) under section 851(a) of the Code.

Fund borrowed money from a variety of sources in order to obtain capital for the purpose of acquiring equity in, and making loans to, portfolio companies in furtherance of its investment business. Fund currently has approximately \$a of outstanding

indebtedness. Fund represents that the proceeds from the issuance of the repurchased debt instruments are directly traceable, within the meaning of § 1.163-8T of the Income Tax Regulations, to the purchase of securities that produce income described in section 851(b)(2) (Qualifying Income Securities).

Due to current economic conditions, certain debt instruments originally issued by Fund are now trading at significant discounts to their par value (or the holders thereof otherwise have determined that the value of such instruments is less than their par value). Because these debt instruments are selling at substantial discounts, Fund believes that it is in the best interests of its shareholders to repurchase some of the instruments at a discounted price prior to the maturity of the instruments. Fund represents that any repurchase will be in compliance with the 1940 Act. Through these repurchase transactions, Fund will recognize significant DOI income under section 61(a)(12).

### **Law and Analysis:**

Section 851(b)(2) of the Code provides that a corporation shall not be considered a RIC for any taxable year unless it meets an income test. Under this test, at least 90 percent of its gross income must be derived from certain enumerated sources. Section 851(b)(2) defines qualifying income, in relevant part as –

dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the 1940 Act) or foreign currencies, or other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to [the RIC's] business of investing in such stock, securities, or currencies . . . .

Section 2(a)(36) of the 1940 Act defines the term “security” as –

any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 1.163-8T of the regulations prescribes rules for allocating interest expense for purposes of applying section 469 of the Code (the “passive loss limitation”) and sections 163(d) and (h) (the “nonbusiness interest limitations”). Section 1.163-8T(a)(3) provides in general that interest expense on a debt is allocated in the same manner as the debt to which such interest expenses relate is allocated. Debt is allocated by tracing disbursements of the debt proceeds to specific expenditures under the rules prescribed by § 1.163-8T. Section VI of Notice 89-35, 1989-1 C.B. 675, modifies the 15 day rule for tracing disbursements of debt proceeds in §§ 1.63-8T(c)(4)(iii)(B) and (5)(i) by expanding the time period to 30 days.

DOI income is not specifically enumerated as one of the items of gross income in section 851(b)(2). However, Fund’s DOI income may be qualifying income under section 851(b)(2) if it is “other income” that is derived with respect to Fund’s business of investing in securities. In determining whether certain income of a RIC is derived with respect to the RIC’s business of investing in securities, there must be a direct connection between the “other income” and the RIC’s business of investing in securities.

In order to demonstrate a direct connection between Fund’s DOI income and Fund’s business of investing in securities, Fund represents that the proceeds from the issuance of the repurchased debt instruments can be traced, within the meaning of § 1.163-8T and Section VI of Notice 89-35, to the purchase of Qualifying Income Securities. Fund further represents that the debt instruments are securities as defined in section 2(a)(36) of the 1940 Act and thus are securities for purposes of section 851(b)(2) of the Code.

Authorities under § 1.163-8T are not controlling for purposes of section 851(b)(2), but may provide useful guidance in interpreting substantially similar concepts arising under section 851(b)(2). Although Fund is not required by section 851(b)(2) to trace the proceeds of the debt instruments to the purchase of Qualifying Income Securities, the ability to trace is one way to demonstrate the direct connection between the DOI income and Fund’s business of investing in Qualifying Income Securities.

**Conclusion:**

Based on the facts as represented, we rule that, to the extent the proceeds of the debt instruments can be traced to the purchase of Qualifying Income Securities within the meaning of § 1.163-8T, the DOI income from the repurchase of the debt instruments is qualifying income for purposes of section 851(b)(2) because the DOI income is other income derived with respect to Fund’s business of investing in securities.

Except as expressly provided herein, no opinion is expressed concerning any federal income tax consequences related to the facts herein under any other provisions

of the Code. Specifically, we express no opinion as to whether Fund qualifies as a RIC, or whether the net proceeds from Fund's issuance of the debt instruments are directly traceable to the purchase of Qualifying Income Securities within the meaning of § 1.163-8T.

This ruling is directed only to the taxpayer who requested it, and is limited to the facts as represented by the taxpayer. Section 6110(k)(3) provides that this letter may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

David B. Silber  
David B. Silber  
Chief, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions and Products)